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FTS 2000

GSA Must Resolve Critical Pricing Issues



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United States
General Accounting Office
Washington, D.C. 20548

Information Management and
Technology Division

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September 11, 1991

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

As agreed with your office, this report assesses the effectiveness of the General Services Administration's (GSA) efforts to obtain competitive rates for telecommunications services under the Federal Telecommunications System (FTS) 2000 contracts.

GSA awarded the FTS 2000 contracts to American Telephone and Telegraph (AT&T) Company and US Sprint Communications Company in December 1988, to replace the government's outdated FTS system with advanced telecommunications services. A major objective of FTS 2000 is to provide telecommunications services at a cost comparable to or below commercial levels. Details of our objective, scope, and methodology appear in appendix I.

Results in Brief

The government has paid substantially above commercial prices for FTS 2000 services and will continue to do so through the next fiscal year unless prices are reduced.¹ In our estimation, for fiscal years 1991 and 1992, FTS 2000 prices for switched-voice services will exceed commercial rates by \$148 million.²

GSA has taken positive steps to reduce prices, but a significant gap between commercial prices and FTS 2000 remains. The vendors assert that this gap exists because of FTS 2000 contract requirements that are beyond typical commercial services. However, GSA has not been able to determine if the cost of these additional requirements is warranted. We question whether these additional services are worth an additional \$148 million over 2 years.

¹The commercial price we used was developed by the MITRE Corporation. It is comprised of a weighted average of AT&T's Software Defined Network tariffs over time. MITRE has a contract with GSA to provide it with FTS 2000 technical support, including conducting traffic and pricing analyses.

²Switched-voice service, i.e. non-dedicated voice service, represents about 90 percent of FTS 2000 revenue for fiscal year 1991 and 80 percent for fiscal year 1992.

GSA will soon begin price redetermination with the two vendors, at which time it has an opportunity to address this issue.³ It is essential that during price redetermination GSA be able to place a value on added requirements. Failure to do so limits the government's ability to determine if prices are competitive with available commercial prices for equivalent services.

Background

FTS 2000 is being implemented to provide state-of-the-art voice, data, and video telecommunications services for the federal government over a 10-year period. Transition to the new system was completed in June 1990, 18 months ahead of schedule; by April 1991, FTS 2000 had more than 1.3 million users. In fiscal year 1992 alone FTS 2000 is expected to handle nearly 3 billion minutes of switched-voice traffic.

In administering the contracts, GSA is responsible for ensuring that the government pays competitive prices for FTS 2000. Consequently, to ensure that FTS 2000 prices are comparable to market prices, GSA developed a price-cap requirement that mandated that vendors' switched-voice prices be no more than publicly available prices. Finally, GSA expected to obtain lower prices, through economies of scale, by effectively enforcing mandatory use and buying telecommunications services in bulk.⁴

When the contracts were awarded in December 1988, both vendors' average switched-voice prices were within range of the average commercial rate. However, in mid-1989, even before any agencies had moved their traffic onto FTS 2000, the average commercial rate for switched-voice service fell precipitously, by nearly 35 percent. As a result, when transition to the network began in October 1989, FTS 2000 switched-voice prices were between 20 and 50 percent higher than the average commercial rate.

³Under price redetermination, at the end of the fourth and seventh years of the contracts, GSA can target 40 percent of each vendor's estimated revenue for recompetition. Only the incumbent FTS 2000 vendors will be permitted to participate in price redetermination.

⁴Under Public Law 101-509, federal agencies must use FTS 2000 services unless (1) they have requirements that cannot be met under the contracts, and (2) agencies' acquisitions of these requirements are cost-effective and would not adversely affect the cost-effectiveness of FTS 2000.

Vendors' Prices Remain Well Above Commercial Rates

The government—nearly 3 years into the contracts—continues to pay considerably above commercial rates for FTS 2000 services. In effect, a key objective of FTS 2000—to provide telecommunications services priced comparably to or below commercial rates—is not being met.

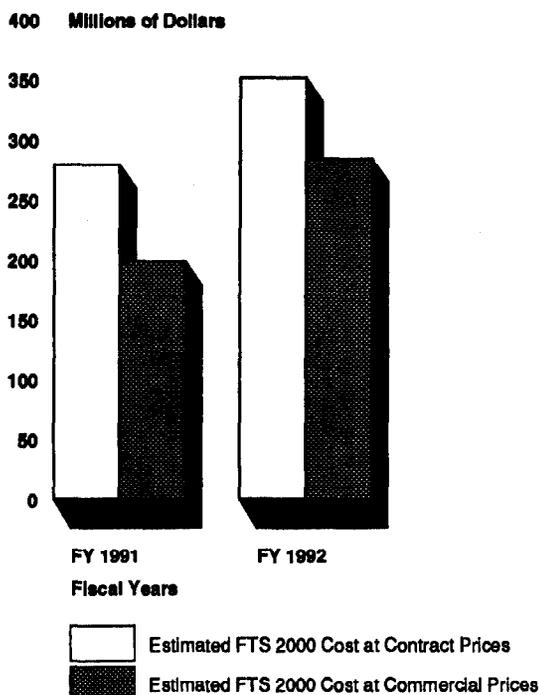
Both vendors' fiscal year 1992 prices for switched-voice service are estimated to be nearly 20 percent higher than the average commercial rate. According to our analysis of actual and projected vendor traffic volumes and prices for switched-voice service, in fiscal year 1991 FTS 2000 will cost the government an estimated \$81 million more than if commercial prices were being charged. For fiscal year 1992, Sprint has agreed to reduce its prices; however, even after these price reductions are taken into account, switched-voice service under FTS 2000 will, we estimate, cost the government about \$67 million more than if commercial prices were being charged.⁵ In total, under FTS 2000 the federal government will pay \$148 million above commercial rates for switched-voice service over these 2 years (see fig. 1).

Sprint's prices for switched-voice service have been significantly higher than AT&T's, and this difference in price has also resulted in higher costs to the government. During the first 3 years of the contracts, the government paid significantly more than if the vendors' prices were comparable, or if all FTS 2000 traffic had been allocated to the lower priced vendor, AT&T. Of the \$81 million paid in excess of commercial rates in fiscal year 1991, we estimate, about \$30 million is due to the difference between AT&T's and Sprint's prices. However, this price difference between the vendors drops to about \$4 million in fiscal year 1992, when Sprint's price reductions take effect.

Prices for data services are also significantly higher than commercially available prices. Data services will make up about 20 percent of the vendors' FTS 2000 revenue in fiscal year 1992. In some cases, according to a May 1991 MITRE analysis, the government has been paying 60 percent more for certain data transmission services than it would on the commercial market.

⁵These estimates do not include GSA's overhead charges of about \$51 million yearly.

Figure 1: Comparison of FTS 2000 and Commercial Switched-Voice Service Costs



NOTES:

(1) Cost estimates based on traffic and pricing data obtained from the MITRE Corporation.

(2) Commercial cost estimate based on a weighted average of AT&T Software Defined Network tariff prices.

Vendors Assert FTS 2000 Services Are Not Comparable to the Commercial Market

The FTS 2000 contracts require the vendors to provide services not required for commercial customers; and—according to the vendors—these additional services must be taken into account when comparing prices. (See app. II and app. III for additional information on FTS 2000 requirements.) AT&T contends that the FTS 2000 contract requires dedicated program management and network support that is unparalleled in the commercial marketplace. Sprint maintains a similar position, stating that under FTS 2000 it must provide added services that are over and above those incurred in the commercial world, at an extra cost of over \$28 million per year. According to Sprint these functions include account support, custom design engineering, program management, custom billing support, and others.

GSA agrees that FTS 2000 requires the vendors to provide a number of unique services, such as National Security Emergency Preparedness requirements to provide continuity of service in times of national emergency, and that these services add to FTS 2000 costs. However, GSA cannot presently quantify the incremental effect of these additional services on FTS 2000 prices.

Further, GSA believes that many of the services the vendors identify as additional requirements—such as maintenance, network control, program management, and user troubleshooting—are not unique to FTS 2000. In a June 18, 1991, letter to AT&T concerning FTS 2000 prices and services, the GSA contracting officer stated, “The issue, as it has been all along, is that the FTS 2000 program coupled with mandatory use, is larger than any other private network, and, as such, should have the best prices available in the industry.”

GSA's Actions Have Resulted in Some Price Reductions

GSA has had success in getting FTS 2000 switched-voice prices reduced over the past 2 years. In the fall of 1989, GSA notified both vendors that they were exceeding the price caps mandated by the contracts and asked them to lower their prices. Both AT&T and Sprint disputed GSA's interpretation of the price-cap provision.

The dispute continued for nearly a year, and resulted in GSA's reassigning the Navy from AT&T to Sprint in return for a volume discount from Sprint worth about \$43 million over 2 years. In addition, GSA and Sprint developed an index to effect price changes over the remaining 2 years of the first contract period. Meanwhile, GSA and AT&T continued to negotiate a price-cap index for AT&T's switched-voice prices.⁶

This past April we provided testimony stating that GSA's agreement with Sprint may not be in the government's best interests, and that the reassignment of the Navy from AT&T to Sprint was not justified.⁷ Subsequently, GSA suspended the assignment of the Navy to Sprint, and initiated a review of the entire matter.

On August 6, Sprint and GSA agreed on a Sprint proposal to reduce FTS 2000 prices. Specifically, the two parties agreed that

⁶As of September 5, 1991, AT&T and GSA had yet to agree on a methodology to calculate a price cap for switched-voice service.

⁷General Services Administration's Management of FTS 2000 (GAO/T-IMTEC-91-9, Apr. 18, 1991).

- Navy traffic on FTS 2000 would be reassigned from Sprint back to AT&T;
- effective October 1, 1991, Sprint will reduce its prices an average of 10 percent for all services, and will further reduce its prices on these services an average of 5 percent on January 1, 1992, saving the government about \$37 million; and
- when Sprint's fiscal year 1992 revenue reaches \$192.3 million, an additional 3.5-percent price reduction will apply to all revenues in excess of that amount.

Finally, GSA has been negotiating with both vendors to obtain agreement on a price-cap index for non-switched-voice services (such as dedicated transmission services) and to get them to reduce their prices. In recent months, both vendors have either offered or agreed to provide discounts on certain data transmission services.

GSA's Options for Reducing Prices

GSA has a number of options available for lowering FTS 2000 prices, including

- continuing to negotiate with the vendors to obtain voluntary price reductions;
- reallocating all traffic to one vendor if it is in the best interests of the government;
- terminating the contracts and initiating a new, full and open procurement; and
- conducting price redetermination as provided for in the contracts.

In our opinion, GSA at this point can only effectively use two of these options—redetermination and negotiation with the vendors. With vendor prices virtually identical for the next fiscal year, reallocation based on price would not be cost-effective. Similarly, contract termination would not be likely to save the government money in the next fiscal year because of the time and expense needed for transition.

Currently, GSA is planning to conduct price redetermination during the coming year. Price redetermination is intended to lower prices by competing a target of 40 percent of each vendor's estimated revenue. Within a few weeks, GSA plans to issue a draft price redetermination/service reallocation solicitation to the two vendors for their review and comment. GSA expects the price redetermination process to be completed by December 1992. After GSA receives price proposals from the vendors, each of the options discussed above would need to be reevaluated.

Conclusions and Recommendations

Requirements imposed on the vendors make it difficult to directly compare FTS 2000 rates with commercial rates. However, we do not believe that FTS 2000 has been a good deal for the government. First, the difference in prices between the two vendors has clearly added costs to the government. Second, while recognizing that specialized requirements can add costs, we do not believe that the added value to the government is worth the \$148 million that we estimate the government will pay over commercial rates in fiscal years 1991 and 1992. We believe, as does GSA, that the sheer size of FTS 2000—coupled with mandatory use—should result in the best prices available in the industry. In its evaluation of proposals during price redetermination it is imperative for GSA to focus on two primary considerations:

- Any price differential between the two vendors must be minimal and not exceed the cost of reallocating traffic to the lower cost vendor. There is no reason for the government to pay higher costs to one vendor if the identical service is offered at a significantly lower cost by the other vendor.
- Proposal prices that are higher than prevailing commercial rates must be carefully evaluated to provide assurance that additional requirements imposed by the government are worth any additional cost. This is particularly important since price redetermination is limited to the two existing vendors. GSA must have in place a methodology to provide assurance that the vendors' proposed prices are, in fact, a good deal for the government when compared to commercial prices.

Accordingly, we recommend that the Administrator, GSA, direct the FTS 2000 program staff to develop an accurate measure of comparable commercial rates that takes into account the value of any services provided under the FTS 2000 contracts that are not typically provided under commercial contracts. This measure should then be used during price redetermination to evaluate the vendors' bids. Further, GSA needs to make sure that it has an effective process in place to keep prices at a favorable rate throughout the life of the contract.

Further, if price redetermination fails to yield prices that are favorable to the government in comparison to commercial prices, GSA should consider alternatives including reallocating all FTS 2000 traffic to one vendor if appropriate, or conducting a new, full and open competition.

We conducted our review from June through September 1991, in accordance with generally accepted government auditing standards. In accordance with your wishes, we did not obtain official agency comments on a draft of this report.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies to the Chairman of the House Committee on Government Operations, the Administrator of General Services, and other interested parties. Copies will also be made available to others upon request. This report was prepared under the direction of Jack L. Brock, Director, Government Information and Financial Management, who can be reached at (202) 275-3195. Other major contributors are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Ralph V. Carlone". The signature is written in a cursive, flowing style.

Ralph V. Carlone
Assistant Comptroller General

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Figure 1: Comparison of FTS 2000 and Commercial Switched-Voice Service Costs

Abbreviations

AT&T	American Telephone and Telegraph Co.
FTS	Federal Telecommunications System
GAO	General Accounting Office
GSA	General Services Administration
IMTEC	Information Management and Technology Division

Objective, Scope, and Methodology

As agreed with the office of the Chairman, Senate Committee on Governmental Affairs, our objective was to assess the effectiveness of GSA's efforts to obtain competitive rates for telecommunications services under FTS 2000. To accomplish our objective, we (1) obtained and reviewed documentation relating to GSA's efforts to reduce vendors' FTS 2000 prices and (2) interviewed GSA and vendor officials to identify the basis for their arguments regarding the issue of FTS 2000's prices exceeding commercially available rates.

To determine the extent to which FTS 2000 switched-voice service prices will exceed commercial rates, and the impact this has on costs in fiscal years 1991 and 1992, we compared actual and projected FTS 2000 switched-voice prices against an average commercial rate for these fiscal years. We then developed an estimate of switched-voice service costs at commercial prices, using actual and projected FTS 2000 traffic and commercial price data, and compared this amount to FTS 2000 switched-voice cost estimates. To determine the additional costs of having two vendors, we used actual and projected FTS 2000 traffic and pricing data to estimate the switched-voice service cost if all traffic were on the lower-cost vendor's network. We then compared this amount to FTS 2000 switched-voice cost estimates.

The switched-voice traffic and pricing data were obtained from the MITRE Corporation. The average commercial rate used in our estimates, as developed by MITRE, is a weighted average of AT&T's Software Defined Network tariffs over time. We did not independently verify the accuracy of the data obtained from MITRE. The MITRE Corporation has a telecommunications management support contract with GSA that, among other requirements, provides GSA with ongoing FTS 2000 technical support. As such, it plays a key role in providing GSA with FTS 2000 traffic, pricing, and revenue analyses as required. In addition, MITRE is playing a major role in assisting GSA with planning and conducting price redetermination.

We conducted our review at GSA's price redetermination facility located at the MITRE Corporation in McLean, Virginia; and AT&T and Sprint offices in the Washington, D.C., area.

Additional FTS 2000 Requirements—US Sprint

According to Sprint, FTS 2000 requires it to provide a number of additional services to the government, services it does not normally provide commercial customers, as identified below.

Network translation

Service delivery points grade of service

- Single-line sets
- Multi-line key telephone systems
- Private branch exchange
- Centrexes
- Data circuit—terminating equipment

Grade of service requirements

Customer service administration

- Service orders
- User troubles
 - User trouble reporting
 - Trouble handling
 - Trouble report data access

Credit adjustments

User complaints

- Entering/handling complaints
- User feedback
- User complaint data access

Government training

- Executive
- General user
- Agency administration and operations
- Service Oversight Center administration and operations
- Supplemental training

User assistance

Billing system

- Shared-location billing
- Billing system verification
- Ordering process new/expanded services

Monthly billing process
Billing data retention

Network operations and management

Transition and cutover management

72-hour acceptance testing

Additional FTS 2000 Requirements—AT&T

According to AT&T, FTS 2000 has a number of requirements that it must fulfill that are not demanded by commercial customers, as identified below.

One-time minimum (\$270 million)

Indefinite delivery, indefinite quantity contract

10-year pricing

- Usage-based services

- Fixed access rates

- Scheduled decreases

- Can never increase pricing

Six major services in one contract

Executive Program Board

Dedicated features

- Network management center

- Service request and status

- Provisioning

- Maintenance

- Billing

- Account inquiry

- Systems and data center

- Marketing to agencies

“In line” management of principal processes

Government access to systems

Attendant services

Service planning department

Detailed test and acceptance plans

Technical Advisory Center

Training

Service analysis tool for users

Bell Labs Office of Chief Technologist

Service Oversight Center (network software)

Technological refreshment (standards & features)

National Security Emergency Preparedness

Hardened relocation site

Dedicated network backbone to support insularity

Internal contract competition (years 4 & 7)

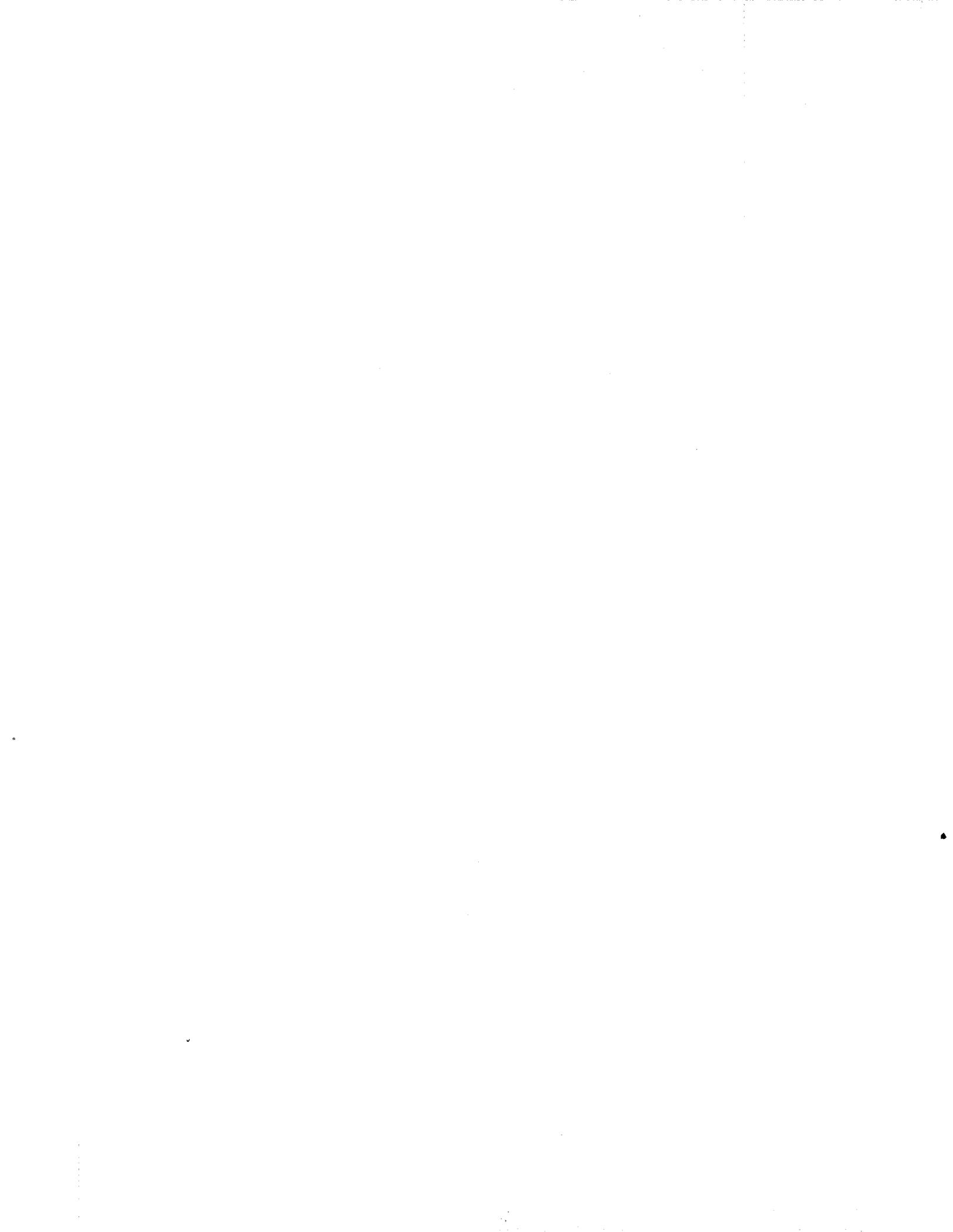
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